In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 923

SAGER GLOVE CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

In 1940 the taxpayer instituted suit under the federal antitrust laws against certain optical companies (Pet. 23, 30–34). The amended complaint listed nine elements of damages, including three recitals of loss of profits resulting from the alleged wrongful acts (Pet. 23, 32–33). At trial Sager, taxpayer's president testified that the taxpayer had lost profits of $346,132 over the period 1936–1943 as a result of the defendant's illegal acts (Pet. 34). The jury returned a verdict for the taxpayer in the amount of $325,000, and the court awarded triple this amount together with costs and charges, and attorneys' fees of $132,000 (Pet. 23–24, 36). A motion for a new trial was granted, but the

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parties on December 19, 1951, compromised their differences out of court. The compromise agreement began (Pet. 36–37):

> Whereas, upon the trial of said cause, plaintiff claimed damages for the period commencing January 1, 1936 through December 31, 1943, in the amount of $346,142.00; and
>
> Whereas the court in said proceeding fixed the reasonable attorneys' fees of plaintiff in the sum of $132,000 * * *.

It then stated that petitioner would be paid the sum of these two amounts, $478,142, in full settlement of its claims (Pet. 36–38).

On its income tax return for 1951 the taxpayer reported as ordinary income the amount of $159,380, equal to one-third of the total settlement; the balance of the settlement, namely, $318,762, was reported by the taxpayer on its return as non-taxable income, with the explanation "Punitive damages awarded in Federal District Court for Anti-Trust Suit" (Pet. 24, 38). The Commissioner concluded that the full amount of $478,142 was taxable as ordinary income and determined a deficiency (Pet. 38–39). In the Tax Court the taxpayer did not contest the inclusion as ordinary income of $132,000 (the amount the settlement attributed to attorneys' fees); the controversy related only to the balance, namely, $346,142 (R. 39). The Tax Court held that this balance of $346,142, which "was the amount which, at the antitrust trial, the petitioner's president, Sager, testified represented the estimated lost net profits from the goggles business over that period," represented com-

pensation for lost profits and was therefore taxable as ordinary income (Pet. 41, 43). The court of appeals affirmed (Pet. 23–27).

It is well established that the taxability of the proceeds of a lawsuit depends upon the nature of the claim and the actual basis of recovery. See, for example, *United States* v. *Safety Car Heating Co.*, 297 U.S. 88; *Durkee* v. *Commissioner*, 162 F. 2d 184 (C.A. 6); *Raytheon Production Corp.* v. *Commissioner*, 144 F. 2d 110 (C.A. 1), certiorari denied, 323 U.S. 779; *Carter's Estate* v. *Commissioner*, 298 F. 2d 192 (C.A. 8), certiorari denied, 370 U.S. 910. The latter three decisions hold that if the settlement proceeds in an anti-trust action represent restitution for loss of profits, they are taxable as ordinary income, and if they represent restitution for loss of a capital asset, they are not taxable except to the extent that the amount of the proceeds exceeds the cost of the asset. As to this controlling rule of law there is no conflict among the courts of appeals, and we believe no dispute between the parties. The question in this case, which is analogous to that in *Durkee*, *Raytheon*, and *Carter's Estate*, is whether the settlement proceeds represented loss of profits and were therefore taxable as ordinary income, or whether they represented damages for the destruction of some capital asset associated with the taxpayer's goggles business. While this question of characterization is admittedly very troublesome, the court below followed the practice adopted by the other courts of appeals and looked to the way the parties themselves characterized the transaction.

The settlement agreement clearly shows that the amount of $346,142, which is now in dispute, was considered by the parties to represent compensation for the loss of profits claimed by the taxpayer. The release begins by declaring that the taxpayer claimed damages of $346,142 for the period 1936–1943. That figure—an obvious reference to Mr. Sager's testimony that the taxpayer had lost profits of $346,132 during that period—was then made the amount of the actual damages which, along with lawyers' fees, were paid to the taxpayer in exchange for a release of his claims.

There is no conflict among the courts of appeals as to the legal principles involved. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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